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Outlook for the Economy and Real Estate

Forecasting & Policy
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The Outlook for the Economy and Real Estate

Growth in GNP and its Components

Growth in the economy should rebound modestly in the fourth quarter as the trade sector exerts a positive influence on economic activity for the first time since March. Contributing to this improvement, oil imports are expected to decline significantly during the fourth quarter after rising sharply earlier this year. At the same time, exports are expected to register another solid gain. As a result, export growth net of imports should add over one full percentage point to GNP growth. Further, spending and investment will likely be fueled by taxpayers' efforts to take advantage of expiring provisions in the tax code. Consumer's will accelerate purchases of "big ticket" items in order to deduct the sales tax before year end. Similarly, businesses will attempt to complete construction projects before the 1987 deadline when depreciation schedules will be lengthened. However, this rebound in the fourth quarter reflects temporary factors and does not indicate any underlying strength in economic activity. Consequently, while growth is expected to increase 3.0 percent during the fourth quarter, this rebound in economic activity will be short lived and, by 1987, growth in the economy is expected to slow considerably.

The outlook for 1987 will be characterized by transition as many sectors of the economy adjust to tax reform and an aging recovery. The spending binge of the past 2 years will likely come to an end next year as a debt-burdened consumer attempts to replenish his savings and pay off his loans. Growth in nonresidential investment will be virtually non-existent in 1987 because a large part of the declines occurred in 1986 in anticipation of tax reform. The major stimulus to growth in 1987 will come from the trade sector as the impact of a depreciating dollar will likely boost import prices relative to the prices of their domestic counterparts. As U.S. manufacturers regain their competitive edge, export growth is expected to finally outpace import growth next year leading to a long-awaited turnaround in the nation's trade performance. Growth in real GNP is likely to remain below two percent for the first half of 1987 before rebounding modestly late in the year. For all of 1987, real GNP is expected to increase 2.2 percent. By 1988, real GNP growth should improve increasing at a rate of 2.9 percent.

Unemployment and Inflation

The unemployment rate in November remained unchanged at 7.0 percent while nonfarm payroll employment increased a strong 249,000 jobs. While job gains continued to be concentrated in the service sector, employment within the manufacturing sector grew for the second consecutive month. A large part of this gain in employment occurred in the export-oriented industries. This is consistent with our fourth quarter projections of strong growth in the export sector. As growth slows in 1987, the unemployment rate is expected to rise above 7.0 percent as job-seekers outpace job openings.

Inflation and Prices

While there will be two opposing forces affecting inflation next year the dominant pressures will be downward. The major factor restraining inflation in 1987 will most likely be lower labor costs which currently comprise over two-thirds of total costs. At the same time, however, the effect of the declines in the dollar and the expected run-up in oil prices, should put upward pressure on overall prices. Consequently, consumer price inflation is expected to increase a modest 3.1 percent in 1987, compared to the 2.0 percent rate projected for 1986.

Interest Rates

The bond market continues to rally as monthly indicators continue to point to slower growth in the months ahead. Consequently, long-term interest rates declined by over 50 basis points since mid-November. In addition, the latest banking figures released by the Federal Reserve Board (Fed) show that the Fed has been especially generous in supplying reserves to the banking system in an effort to alleviate pressures caused by seasonal and technical factors. However, despite news of slowing growth, the Fed will move cautiously to lower interest rates, and a discount rate cut is not expected until early next year. Therefore, during the fourth quarter, both long- and short-term interest rates are expected to remain stable.

By 1987, fiscal policy will play a major role in exerting downward pressure on interest rates. Attempts by Congress to reduce the deficit through adherence to Gramm-Rudman-Hollings deficit targets has sent a positive signal to the financial markets that future deficits will, at the very least, decline. Further, tax reform, because it dampens investment and provides disincentives to borrowing, will reduce the demand for loanable funds thus, easing credit conditions. As a result, both long- and short-term interest rates are expected to trend slowly downward through next year. However, by 1988, the path of short- and long-term interest rates should diverge. As long-term interest rates begin to stabilize, short-term interest rates should begin to edge upward as renewed vigor in the economy and a modest acceleration in prices signals caution to the Federal Reserve.

As investors seek higher yields and mortgage securities continue to record outstanding performance in the mortgage securities markets, the spread between long-term treasury bond rates and mortgage rates should begin to narrow. Consequently, mortgage rates will likely continue to decline through 1987, dipping below 8.5 percent by year end.

Real Estate Markets

Existing homes continued to be sold at a healthy pace. In September and October, over 3.7 million homes were sold, the fastest pace in 7 years. New construction, on the other hand, is beginning to feel the bite of tax reform. Both single and multi-family starts have recorded sharp declines over the past few months. These trends are likely to continue. With mortgage interest rates expected to decline to 8.5 percent by mid-1987, sales of existing homes should remain at a healthy pace despite slower growth and tax reform. In 1987, over 3.5 million homes are expected to be sold. However, new construction is not expected to fare as well, largely due to tax reform. Single family starts are expected to decrease by over 7 percent, while multi-family starts are expected to decline over 20 percent.

The rate of appreciation of home prices will also differ depending on whether they are existing or new homes. The existing home median price should continue to outpace inflation next year increasing by 4.0 percent. New homes, however, will face a tighter market. Until recently, the demand for new construction has been strong enough to support large profits. However, with demand subsiding from its heated pace of early 1986, buyers will become more price resistant. Therefore, builders will likely have to moderate prices in an effort to sustain new home sales and starts. Consequently, new home prices are expected to appreciate less than 3.0 percent next year.

Table 1

DECEMBER 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,176	4,241	4,297	4,342	4,394	4,451	4,514	4,582	3,765	3,998	4,216	4,425	4,688
% Change	2.6	6.4	5.4	4.3	4.8	5.4	5.7	6.1	10.5	6.2	5.4	5.0	5.9
% Change (w/out inflation)	0.6	2.9	3.0	1.7	1.9	2.7	2.5	3.0	6.4	2.7	2.6	2.2	2.9
Consumption	6.2	6.5	1.5	2.2	1.5	1.7	1.3	1.7	4.7	3.5	4.0	2.0	1.7
Durables	14.3	39.7	21.2	1.4	0.6	1.1	2.0	0.7	12.7	7.8	5.9	1.2	2.1
Nondurables	8.0	1.1	2.3	2.0	1.4	1.6	1.2	1.9	3.6	1.6	3.7	1.8	1.6
Services	2.6	3.4	2.8	2.5	1.9	2.0	1.2	1.9	3.4	3.7	3.5	2.4	1.7
Residential Investment	14.5	9.7	8.6	8.7	7.2	1.2	6.1	3.1	14.3	3.9	8.5	2.8	1.0
Nonresidential Investment	0.9	0.1	1.9	0.7	0.0	0.5	2.5	0.1	16.9	9.3	0.8	0.3	1.5
Structures	35.2	8.2	2.5	1.2	0.9	0.9	0.6	0.3	11.1	7.7	11.2	4.7	1.6
Equipment	19.6	3.4	3.7	0.5	0.3	0.4	3.7	0.0	20.0	10.1	4.3	2.4	1.5
Exports	9.8	9.3	8.3	8.9	11.3	15.3	14.4	13.7	6.2	2.0	1.6	9.2	13.1
Imports	15.8	14.7	2.9	1.7	1.1	3.6	0.3	2.8	23.2	3.8	9.9	3.2	2.6
Government Purchases	9.7	7.6	7.1	5.3	1.1	4.5	8.3	5.2	4.0	6.8	3.7	2.7	1.9
Contribution to GNP Growth (Percentage Points)													
Consumption	4.0	4.3	1.0	1.4	1.0	1.1	0.9	1.1	2.4	2.3	2.4	1.1	1.3
Residential Investment	0.7	0.5	0.5	0.5	0.4	0.1	0.3	0.2	0.2	0.4	0.3	0.1	0.0
Nonresidential Investment	0.1	0.0	0.2	0.1	0.0	0.1	0.3	0.0	1.7	0.8	0.5	0.1	0.2
Structures	1.7	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.5	0.1	0.6	0.0	0.1
Equipment	1.6	0.3	0.3	0.0	0.0	0.0	0.3	0.0	1.2	0.7	0.1	0.1	0.1
Inventory Change	2.7	2.3	1.6	1.4	0.1	0.5	2.0	2.0	0.2	1.1	0.4	0.3	0.4
Net Exports	3.0	1.1	1.2	0.6	1.0	1.0	1.4	1.1	1.4	1.1	0.6	1.0	0.8
Government Purchases	1.9	1.5	1.4	1.1	0.2	0.9	1.6	1.1	1.5	1.6	0.5	0.4	0.3
Mfg. Capacity Utilization	79.5	79.8	79.6	79.1	78.6	78.5	78.3	78.3	80.8	80.3	79.7	78.6	78.2
Domestic Auto Sales	8.1	9.7	7.1	6.9	7.3	7.1	7.2	7.0	8.0	8.2	8.2	7.1	7.2
Personal Income Per Household	41,967	42,100	42,489	42,945	43,340	43,757	44,208	44,788	36,800	40,557	42,295	43,870	45,874
Percent Change	4.7	3.9	4.0	2.3	2.9	3.0	2.9	3.3	6.6	10.2	4.3	3.7	4.6
Personal Taxes Per Household	6,082	6,239	6,312	6,171	6,252	6,338	6,425	6,187	5,201	5,953	6,204	6,340	6,386
Percent Change	9.6	4.5	3.1	1.5	0.2	0.4	4.1	1.1	6.2	14.5	4.2	2.2	0.7
Percent of Disposable Income	14.49	14.82	14.86	14.37	14.43	14.49	14.53	13.81	14.13	14.68	14.67	14.45	13.92
Disposable Personal Income Per Household	35,886	35,862	36,177	36,774	37,088	37,419	37,783	38,601	31,598	34,604	36,092	37,529	39,488
Percent Change	5.0	3.0	3.8	2.5	3.4	3.4	2.7	4.1	3.2	9.5	4.3	4.0	5.2
Employment (millions) (civilian household basis)	109.2	110.0	110.3	110.5	110.9	111.2	111.6	111.9	105.0	107.2	109.6	111.1	112.6
% Change	1.7	2.8	1.1	1.0	1.2	1.3	1.3	1.2	4.1	2.1	2.2	1.4	1.4
Unemployment Rate (%) (civilian household)	7.2	6.9	7.0	7.1	7.2	7.2	7.1	7.1	7.5	7.2	7.0	7.1	6.9
Consumer Prices (CPI)	1.7	2.6	4.2	3.0	3.5	3.2	4.2	3.6	4.3	3.5	2.0	3.1	3.7
GNP Deflator	1.8	3.6	2.4	2.5	2.9	2.6	3.1	3.1	3.9	3.3	2.8	2.7	3.0
Personal Cons. Inflation	1.1	3.2	3.6	3.0	3.5	3.2	4.0	3.5	3.8	3.5	2.1	3.1	3.6
Residential Construction Inflation	5.6	2.9	3.0	2.2	3.9	3.7	3.5	3.3	4.1	1.8	3.4	3.2	3.8
Nonresidential Const. Inflation	0.4	2.8	4.5	2.6	3.0	2.2	2.8	2.7	0.2	0.7	1.5	2.8	2.8
Producer Price Inflation	5.5	0.4	4.3	3.8	4.1	3.6	4.2	4.0	2.1	0.9	1.4	2.9	4.1
Before Tax Corporate Profit	231.3	241.3	280.6	280.2	285.0	289.8	302.8	304.1	235.7	225.1	244.4	289.5	309.7
Corporate Tax Liability	93.3	97.3	132.6	142.9	147.0	148.8	154.1	146.7	95.4	91.7	103.1	148.2	148.9
After Tax Profits	138.0	144.0	148.0	137.3	138.0	141.0	148.7	157.4	140.3	133.4	141.3	141.3	160.8
Inventory Valuation Adjustment	10.6	8.0	6.3	2.5	7.2	7.0	10.5	8.8	5.5	0.5	7.2	6.8	10.9
Capital Consumption Allowance	51.3	50.2	49.1	36.9	36.6	36.8	36.7	36.7	34.5	58.1	51.5	36.8	36.2
Federal Tax Receipts (NIPA)	807.7	826.1	867.6	874.3	887.3	898.7	913.1	897.8	726.5	786.9	825.3	893.4	922.3
% of GNP	19.3	19.5	20.2	20.1	20.2	20.2	20.2	19.6	19.3	19.7	19.6	20.2	19.7
Federal Expenditures (NIPA)	1045.7	1031.9	1052.0	1054.7	1058.9	1071.7	1093.3	1096.3	896.5	984.9	1032.8	1069.6	1114.5
% of GNP	25.0	24.3	24.5	24.3	24.1	24.1	24.2	23.9	23.8	24.6	24.5	24.2	23.8
Deficit(NIPA)	-238.1	-205.8	-184.4	-180.4	-171.6	-173.0	-180.2	-198.5	-170.0	-198.0	-207.5	-176.3	-192.2
% of GNP	5.7	4.9	4.3	4.2	3.9	3.9	4.0	4.3	4.5	4.9	4.9	4.0	4.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

Table 2

REAL ESTATE AND FINANCIAL MARKETS

DECEMBER 1986

	Actual		QUARTERS Forecast						YEARS Actual		YEARS Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single Family Home Sales (single family resales and completions)	4.669	4.725	4.824	4.624	4.572	4.666	4.741	4.775	3.933	4.254	4.672	4.651	4.702
Percent Change -- Year Ago	14.5	8.0	6.2	5.3	-2.1	4.6	2.4	0.5	4.9	8.2	9.8	-0.4	1.1
Existing Single Family Home Sales (1000's)	3,470	3,616	3,731	3,590	3,534	3,578	3,643	3,651	2,866	3,214	3,519	3,586	3,593
Percent Change -- Year Ago	14.0	7.6	6.6	10.2	1.8	1.1	-2.4	2.3	5.5	12.1	9.5	1.9	0.2
Dollar Volume (billions)	349	343	349	349	343	335	350	359	247	291	337	344	363
Existing Home Prices -- Median ($1000's)	82.0	80.2	79.4	81.4	83.9	84.6	83.0	84.7	72.3	75.5	79.9	83.1	86.3
Percent Change -- Year Ago	8.6	4.7	5.6	4.3	2.3	4.8	4.5	4.0	3.6	4.4	5.8	4.0	3.9
Monthly Mortgage Payment (P&I,30 yr.)	587	572	559	544	520	509	497	496	619	609	575	517	499
Percent of Median Family Income	24.8	23.9	22.7	22.6	22.3	21.7	21.0	20.7	28.2	26.2	24.1	21.9	20.5
Housing Starts (1000's)	1,908	1,746	1,677	1,554	1,563	1,615	1,633	1,610	1,763	1,741	1,833	1,591	1,627
% Change	9.5	3.5	-5.4	-22.2	18.1	7.5	2.6	3.6	3.4	1.2	5.2	13.2	2.2
Single-Family Units (1000's)	1,238	1,144	1,127	1,067	1,072	1,122	1,133	1,140	1,100	1,073	1,191	1,098	1,132
% Change	15.8	9.2	5.0	-14.9	13.4	1.9	0.5	6.9	3.3	-2.5	11.0	7.7	3.1
Multi-Family Units (1000's)	670	602	550	487	491	493	500	471	663	669	642	493	495
2-4 Family Units	81	75	69	61	62	62	63	59	122	93	82	62	62
% Change	20.9	-15.7	-13.7	-40.2	23.8	18.2	9.1	3.4	7.6	-23.4	12.2	-24.5	0.4
5+ Family Units	590	527	481	426	430	431	437	412	542	576	560	431	433
% Change	3.1	4.2	-22.4	-33.8	-27.1	18.1	9.1	3.4	2.8	6.2	-2.7	-23.0	0.4
Mobile Homes Shipped	238	233	237	240	250	266	278	288	295	283	242	258	298
New Single Family Home Sales (1000's)	737	682	659	648	642	669	675	684	637	689	732	659	662
Percent Change -- Year Ago	15.7	4.1	5.3	-1.9	18.4	1.9	2.4	5.6	1.7	8.4	6.6	9.2	0.4
New Home Prices -- Median ($1000)	91.9	92.3	92.9	93.1	93.5	93.7	94.1	94.6	80.0	84.3	91.4	93.6	96.0
Percent Change -- Year Ago	9.4	10.7	7.0	5.4	1.7	1.5	1.3	1.6	6.0	5.4	8.4	2.4	2.6
New Home Prices -- Average ($1000's)	107.8	107.8	110.4	107.6	111.7	111.8	114.6	111.9	96.8	104	107.3	111.4	116.1
Percent Change -- Year Ago	3.6	3.4	3.8	4.5	3.6	3.7	3.8	4.0	6.6	7.4	3.2	3.8	4.2
NAR Affordability Index	100.5	104.5	111.0	112.6	114.7	115.1	118.9	120.5	75.4	85.9	103.7	114.1	122.0
Mortgage Debt Outstanding($ billions)	2,389	2,422	2,488	2,546	2,606	2,667	2,730	2,793	1,948	2,202	2,413	2,637	2,896
Housing Inventory (millions)	96.5	97.3	97.7	98.2	98.6	99.0	99.4	99.8	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	7.3	7.1	6.9	6.8	6.7	6.5	6.4	6.3	5.8	6.5	7.1	6.6	6.2
Office Vacancy Rate (%)<1>	16.8	16.8	16.9	17.0	16.8	16.7	16.6	16.6	14.7	16.5	16.7	16.6	16.5
Industrial Vacancy Rate (%) <1>	5.7	5.8	5.7	5.7	5.6	5.6	5.5	5.5	4.7	5.0	5.6	5.6	5.4
FINANCIAL MARKETS													
Money Supply (M1)(% change)	16.8	18.4	14.8	11.0	8.1	8.5	7.5	6.8	7.0	9.1	13.0	11.8	6.8
Velocity of M1 (% change)	-12.2	-10.1	-8.2	-6.1	-3.0	-2.9	-1.7	-0.3	-3.3	-2.6	-6.6	-6.2	-0.8
Value of the U.S. Dollar (Trade-Weighted)	114.2	108.3	107.3	106.3	105.4	104.6	104.2	102.3	138.3	143.2	112.4	105.1	100.1
Percent Change	-16.5	-19.1	-3.7	-3.8	-3.3	-3.1	-1.5	-7.2	10.4	3.5	-21.6	-6.4	-4.8
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total gross savings)													
Private Saving	719	662	675	682	681	689	697	750	675	688	693	687	760
Personal Saving	153	90	108	128	124	123	120	157	169	143	124	124	156
Savings Rate	5.1	3.0	3.6	4.2	4.0	3.9	3.8	4.8	6.3	5.1	4.2	4.0	4.7
Gross Business Savings	566	571	567	554	557	566	576	593	506	544	568	563	604
Federal Deficit	-238	-206	-184	-180	-172	-173	-180	-199	-170	-198	-208	-176	-192
State & Local	59	64	63	61	59	56	55	55	69	62	64	58	55
Net Foreign Investment	-143	-145	-143	-142	-145	-144	-139	-127	-91	-115	-140	-142	-122
Uses (total gross investment)	687	675	696	707	709	711	702	729	662	661	692	707	741
Nonresidential Investme	457	457	459	458	458	459	461	462	422	461	458	459	466
Structures	133	130	129	129	129	129	129	129	141	152	135	129	131
Equipment	324	327	330	329	329	330	333	333	281	309	322	330	335
Residential Investment	193	197	193	189	185	186	188	190	171	177	192	187	189
Inventory Investment ($ billions)	15	-6	9	21	22	18	-1	17	59	9	15	15	17
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	9.9	9.9	9.5	9.2	9.0	8.7	8.6	8.5	13.8	12.2	9.9	8.9	8.5
Real Mortgage Rate	4.4	4.8	4.7	4.7	4.8	4.7	4.9	5.0	6.4	5.5	4.6	4.8	5.3
1-year ARM (without buydown)	7.9	7.3	7.2	6.9	6.7	6.3	6.3	6.3	12.5	10.0	7.9	6.5	6.4
Real Mortgage Rate	5.5	4.8	4.5	4.2	3.9	3.4	3.2	3.1	5.6	5.2	5.0	3.7	3.4
Corporate AAA Bond Rate	9.0	8.8	8.6	8.4	8.1	7.9	7.8	7.6	12.7	11.4	9.0	8.1	7.5
Government Bond Rate	7.5	7.4	7.3	7.2	6.9	6.7	6.6	6.6	12.4	10.8	7.7	6.8	6.5
Federal Funds Rate	6.9	6.2	6.0	5.7	5.4	5.2	5.2	5.3	10.2	8.1	6.7	5.4	5.4
3-month T-Bill Rate	6.1	5.5	5.4	5.1	4.9	4.5	4.5	4.5	9.5	7.5	6.0	4.7	4.6
Real 3-month T-Bill Rate	3.7	3.0	2.8	2.4	2.1	1.6	1.4	1.4	5.6	4.2	3.2	1.9	2.0
1-Year T-Bill Rate	6.3	5.7	5.6	5.3	5.1	4.7	4.7	4.7	10.9	8.4	6.3	4.9	4.8
Real 1-Year T-Bill Rate	3.9	3.2	2.9	2.6	2.3	1.8	1.6	1.5	6.1	4.7	3.3	2.1	2.2
Prime Rate	8.6	7.9	7.5	7.4	7.2	6.9	6.7	6.7	12.0	9.9	8.3	7.0	7.0
Discount Rate	6.6	5.8	5.5	5.2	5.1	4.8	4.6	4.6	8.8	7.7	6.3	4.9	4.9

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates - Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

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Outlook for the Economy and Real Estate

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THE OUTLOOK FOR THE ECONOMY AND REAL ESTATE

Eager for good news on the prospects for continued economic growth in 1987, many analysts have seized upon early reports of renewed vigor in retail sales, stronger production and gains in employment as signs of a wonderful year to come. If the truth be told, sales strength in late 1986 was mostly made up of consumers racing to beat the deadline for deductibility of state sales taxes, which depleted auto inventories (among other items), and caused the higher production seen this quarter. The employment progress was mostly explained by striking manufacturing workers returning to work. But while the overall economic growth rate during 1987 will be sluggish at about 2.0 percent, the housing industry, with the exception of multi-family construction, can expect to enjoy another good year.

A closer look at the composition of the slower GNP growth helps to point out the changing forces in the economy that will drive growth in 1987. Up until now, consumption has been the engine of growth as the American consumer has been willing and able to spend. Today, slower growth in personal income has forced the previously "able" consumers to come face to face with the consequences of their spending: high debt burdens and low savings. Even consumers that are still "able" may be less "willing" because the new tax law raises the price of consumption by eliminating the deduction for sales taxes and phasing out the one for consumer interest.

Without the consumption impetus, the prospects for positive growth hinge on a long-awaited turnaround in the U.S. trade balance. The dollar has declined substantially against the currencies of many of our trading partners. This has caused the differentials in labor cost between the U.S. and Japan (among others) to narrow sharply and has begun to reverse the trade imbalance. Moreover, the usual lag between currency value changes and changes in trade flows have about worked their way through the system. All this means that trade should finally contribute positively to GNP growth during 1987 and help to offset declines in the growth of consumer spending.

The key to this outlook for 1987 is the conduct of monetary policy. Lately, the Fed has been most concerned with the slow rate of growth in GNP, encouraging interest rates to fall in order to coax more investment from the economy. The burden on monetary policy is heavy, since massive budget deficits have removed government spending as a means of boosting the economy. But the current monetary policy has had the pleasant side effect of pulling the value of the U.S. dollar down slowly—something the governments of the U.S., Britain, Japan, W. Germany, and France had agreed to pursue together in September 1985, in the hope of resolving world trade imbalances.

But in the last several weeks a seed of doubt has been sown about the Fed's stance on monetary policy. The Fed has now to contend not only with sluggish economic growth, but also with a dollar that is beginning to fall a bit too fast. Complicating the situation is a new stage of the third-world debt crisis and a new round of negotiations between debt-strapped developing countries and their creditors. In all likelihood, the Fed will remain committed to supporting U.S. economic growth, but will probably work with foreign governments to stabilize the dollar's value. This accommodative policy suggests that more inflation could be on the horizon. With oil prices firming up in the $17 to $19 per barrel range, inflation will top 3 percent in 1987 and 1988.

Real Estate Markets

Sales of existing single-family homes closed out 1986 at a strong annual rate of 4.17 million units in December. This brought the 1986 sales total to 3.57 million units representing more than a 10 percent gain over 1985 sales performance. In February, existing single-family home sales reached 3.69 million units. Existing home sales activity will likely show a moderating trend in this first quarter of 1987 to about 3.59 million units, but will gain momentum throughout the year as interest rates stay moderate. Total existing single-family home sales for 1987 should reach 3.62 million units.

Housing starts activity trailed off a bit in January after a very strong 10.8 percent advance in December 1986, but a large part of the January decline was due to continued weakness in multi-family starts. Housing starts rebounded in February by 2.6 percent, and single-family starts rose strongly by 5.6 percent. The new tax law will keep multi-family starts down to about a 500 thousand unit rate during 1987. The good news is that single-family starts should remain very strong in both 1987 and 1988 owing to low interest rates.

Sales of new single-family homes shot up 12.1 percent last December, but then trailed off by 6.8 percent in January of this year, due mostly to the large December rise. The prices of both new and existing single-family homes will still increase at healthy rates over the forecast horizon. Homeowners can expect to see their homes rise in value by an average rate of 4 percent. This rise in prices is a normal consequence of declining interest rates. This means that despite today's lower interest rates, it is possible that housing affordability could rise slowly or stabilize in the next two years and could even decline somewhat.

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS							YEARS			
	Actual		Forecast					Actual		Forecast	
	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1988.2	1985	1986	1987	1988
AGGREGATE ECONOMY												
Gross National Product (billions of dollars)	4240.7	4260.6	4318.8	4374.7	4432.9	4495.6	4564.4	4626.6	3998.1	4206.5	4405.5	4651.0
% Change	6.4	1.9	5.6	5.3	5.4	5.8	6.3	5.6	6.2	5.2	4.7	5.6
% Change (w/out inflation)	2.8	1.3	2.0	1.9	2.6	2.7	3.1	2.5	2.7	2.5	2.0	2.5
Consumption	6.7	-0.1	-1.5	2.8	3.8	0.3	2.3	1.7	3.5	4.1	1.8	1.8
Durables	46.6	-10.0	-24.1	1.6	12.8	-6.6	5.0	2.4	7.8	7.3	-2.2	2.1
Nondurables	-0.9	-0.2	2.7	3.0	2.3	1.5	1.9	1.5	1.6	3.6	1.9	1.8
Services	2.4	3.4	3.6	3.0	2.3	1.5	1.9	1.5	3.7	3.4	2.9	1.8
Residential Investment	9.7	6.2	1.7	-3.6	-3.6	0.9	0.3	1.3	3.9	9.5	2.5	-0.7
Nonresidential Investment	-2.1	1.3	-3.5	0.6	2.2	1.4	3.7	3.0	9.3	-1.1	-0.5	2.3
Structures	-9.8	-7.2	-1.1	1.7	2.2	0.8	2.9	2.8	7.7	-11.7	-5.1	1.9
Equipment	1.2	4.9	-4.4	0.2	2.2	1.7	4.0	3.1	10.1	4.1	1.4	2.4
Exports	13.3	13.6	8.2	7.4	7.2	7.0	7.3	7.0	-2.0	2.4	8.2	7.1
Imports	17.3	-0.2	1.5	2.8	2.5	0.4	3.0	1.8	3.8	10.4	4.1	1.9
Government Purchases	4.5	11.0	-4.5	-0.6	3.2	7.8	-3.9	2.4	6.8	3.6	2.7	2.3
Contribution to GNP Growth (Percentage Points)												
Consumption	4.4	-0.1	-1.0	1.8	2.5	0.2	1.5	1.1	2.3	2.6	0.9	1.0
Residential Investment	0.5	0.3	0.1	-0.2	-0.2	0.0	0.0	0.1	0.4	0.5	-0.1	0.0
Nonresidential Investment	-0.3	0.2	-0.4	0.1	0.3	0.2	0.4	0.4	0.8	-0.6	0.0	0.3
Structures	-0.4	-0.3	0.0	0.1	0.1	0.0	0.1	0.1	0.1	-0.7	0.0	0.0
Equipment	0.1	0.4	-0.4	0.0	0.2	0.1	0.3	0.3	0.7	0.1	0.0	0.2
Inventory Change	-1.7	-2.6	3.7	0.0	-1.0	0.0	1.6	0.0	-1.1	-0.5	0.7	0.1
Net Exports	-1.0	1.3	0.6	0.4	0.4	0.7	0.3	0.5	-1.1	-0.5	0.5	0.5
Government Purchases	0.9	2.2	-1.0	-0.1	0.7	1.6	-0.8	0.5	1.6	0.6	0.3	0.5
Mfg. Capacity Utilization	79.7	79.8	80.2	80.0	79.8	79.7	79.7	79.5	80.3	79.7	79.9	79.2
Domestic Auto Sales	9.7	7.9	7.0	7.3	7.9	7.3	7.4	7.4	8.2	8.4	7.3	7.3
Personal Income	3498.8	3529.6	3573.0	3616.6	3661.5	3707.6	3764.6	3810.9	3314.5	3486.1	3639.7	3834.8
Percent Change	5.3	4.3	4.1	3.8	4.7	5.0	5.4	5.4	6.6	5.2	4.4	5.4
Disposable Personal Income	2979.9	2994.6	3048.0	3082.6	3118.6	3155.4	3213.4	3250.4	2828.0	2972.0	3101.1	3269.4
Percent Change	5.2	3.9	3.8	3.5	4.7	5.4	5.4	5.4	5.9	5.1	4.3	5.4
Employment (millions) (civilian:household basis)	110.0	110.4	111.1	111.4	111.8	112.2	112.6	113.0	107.2	109.6	111.6	113.1
% Change	2.7	1.6	2.5	1.2	1.4	1.4	1.3	1.5	2.0	2.3	1.9	1.3
Unemployment Rate (%) (civilian:household)	6.9	6.8	6.8	6.9	7.0	7.0	7.0	6.9	7.2	7.0	6.9	6.9
Consumer Prices (CPI)	2.6	2.5	4.2	3.4	3.3	3.6	3.5	3.6	3.5	1.9	3.0	3.5
GNP Deflator	3.6	0.7	3.5	3.3	2.8	3.0	3.0	3.0	3.3	2.6	2.7	3.0
Personal Cons. Inflation	3.6	3.2	4.2	3.7	3.1	3.5	3.3	3.4	3.5	2.1	3.3	3.3
Residential Construction Inflation	1.8	2.9	4.0	4.0	3.6	4.1	3.0	4.2	1.8	3.3	3.6	3.7
Nonresidential Construction Inflation	3.2	0.8	2.3	3.4	2.8	3.1	3.0	2.9	0.7	1.4	2.3	3.0
Producer Price Inflation	-0.1	2.5	3.7	4.1	3.9	4.0	3.8	4.0	0.9	-1.4	2.6	4.0
Before Tax Corporate Profit	240.4	250.9	249.4	255.4	255.7	267.0	266.4	270.2	229.1	235.4	256.9	265.3
Corporate Tax Liability	104.5	109.0	131.7	136.5	136.5	141.3	134.9	136.5	...7	102.0	136.5	134.9
After Tax Profits	135.9	141.9	117.7	118.9	119.2	125.7	131.5	133.7	131.4	133.4	120.4	130.4
Inventory Valuation Adjustment	6.1	-7.2	-4.3	-4.9	-3.4	-6.0	-4.7	-7.8	-0.5	6.5	-4.6	-7.1
Capital Consumption Allowance	55.5	59.4	57.6	55.8	54.8	53.9	53.2	52.5	58.1	56.8	55.5	52.1
Federal Tax Receipts (NIPA)	833.1	849.6	870.2	884.9	895.0	909.3	912.3	927.5	786.9	825.7	889.9	933.0
% of GNP	19.6	19.9	20.1	20.2	20.2	20.2	20.0	20.0	19.7	19.6	20.2	20.1
Federal Expenditures (NIPA)	1030.5	1045.5	1048.0	1052.9	1065.1	1087.0	1092.3	1103.8	984.9	1030.8	1063.3	1115.3
% of GNP	24.3	24.5	24.3	24.1	24.0	24.2	23.9	23.9	24.6	24.5	24.1	24.0
Deficit(NIPA)	-197.4	-195.9	-177.8	-168.0	-170.0	-177.7	-180.0	-176.3	-198.0	-205.1	-173.4	-182.3
% of GNP	-4.7	-4.6	-4.1	-3.8	-3.8	-4.0	-3.9	-3.8	-4.9	-4.9	-3.9	-3.9

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick, Janemarie Mulvey and Sean Burns.

Table 2

March-April 1987

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS							YEARS			
	Actual		Forecast					Actual		Forecast	
	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1988.2	1985	1986	1987	1988
REAL ESTATE MARKETS												
Total Single-Family Home Sales (single-family resales and completions)	4732	5011	4735	4712	4760	4765	4773	4787	4255	4723	4743	4697
Percent Change -- Year Ago	8.1	10.3	5.9	0.9	-0.5	-4.9	0.8	1.6	8.2	11.0	0.4	-1.0
Existing Single-Family Home Sales (1000's)	3616	3890	3590	3615	3638	3649	3651	3659	3215	3565	3623	3590
Percent Change -- Year Ago	7.6	12.7	10.2	4.2	0.6	-6.2	1.7	1.2	12.1	10.9	1.6	-0.9
Dollar Volume (billions)	359	393	349	356	353	359	359	352	291	343	355	363
Existing Home Prices -- Median ($1000's)	80.2	80.7	81.4	83.9	84.2	84.9	84.7	87.3	75.5	80.3	83.6	86.9
Percent Change -- Year Ago	4.7	5.6	4.3	2.3	5.0	5.2	4.1	4.0	4.4	6.4	4.1	3.9
Monthly Mortgage Payment (P&I, 30 yr.)	568	571	552	555	547	546	540	557	609	681	592	564
Percent of Median Family Income	23.7	23.7	22.7	22.5	22.0	21.8	21.2	21.7	26.2	23.7	23.9	21.9
Housing Starts (1000's)	1758.3	1700.7	1706.5	1622.9	1635.8	1628.5	1619.4	1643.3	1741.3	1841.3	1648.4	1617.8
% Change	4.2	-4.1	-14.6	-14.9	-7.0	-4.2	-5.1	1.3	-1.2	5.7	-10.5	-1.9
Single-Family Units (1000's)	1150.0	1156.0	1180.3	1130.8	1157.1	1150.3	1156.6	1162.8	1072.5	1199.1	1154.6	1141.5
% Change	9.7	7.6	-5.8	-8.6	0.6	-0.5	-2.0	2.8	-2.5	11.8	-3.7	-1.1
Multi-Family Units (1000's)	608.3	544.7	526.2	492.1	478.7	478.2	462.8	480.5	668.8	642.3	493.8	476.3
2-4 Family Units	76.7	88.3	85.4	79.8	77.6	77.6	75.1	77.9	93.1	86.9	80.1	77.3
% Change	-14.2	10.9	-16.3	-1.0	1.3	-12.2	-12.0	-2.4	-23.4	-6.6	-7.9	-3.5
5+ Family Units	531.7	456.3	440.9	412.3	401.0	400.6	387.8	402.6	575.8	555.3	413.7	399.0
% Change	-3.3	-26.4	-31.5	-30.1	-24.6	-12.2	-12.0	-2.4	6.2	-3.5	-25.5	-3.5
Mobile Homes Shipped	237	244	253	257	271	280	290	301	283	249	265	301
New Single Family Home Sales (1000's)	686	709	686	676	669	654	645	632	689	745	671	665
Percent Change -- Year Ago	-4.5	0.3	-13.1	-14.9	-2.5	-7.8	-6.0	-6.5	8.2	8.1	-9.9	-0.9
New Home Prices -- Median ($1000)	92.3	95.5	93.9	94.6	95.2	95.8	96.3	97.1	84.3	92.0	94.9	97.7
Percent Change -- Year Ago	10.7	10.0	6.3	2.9	3.1	0.3	2.6	2.6	5.4	9.1	3.2	3.0
New Home Prices -- Average ($1000)	101.2	97.8	101.4	103.6	104.4	101.0	105.1	107.4	95.6	99.3	102.6	106.5
Percent Change -- Year Ago	6.4	0.7	4.3	2.8	3.2	3.3	3.6	3.7	2.0	3.9	3.3	3.8
NAR Affordability Index	103.8	109.4	110.3	110.9	113.6	114.8	117.7	115.4	94.8	105.7	112.4	121.5
Mortgage Debt Outstanding ($ billions)	2422	2537	2574	2636	2700	2766	2831	2897	2202	2413	2669	2930
Housing Inventory (millions)	97.3	97.7	98.1	98.6	99.0	99.4	99.8	100.2	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	7.5	7.7	7.4	7.1	6.9	9.7	6.5	6.4	6.5	7.4	7.0	6.3
FINANCIAL MARKETS												
Money Supply (M1)(% change)	17.5	18.1	14.0	7.6	7.5	6.2	6.6	6.0	9.1	13.3	12.7	6.5
Velocity of M1 (% change)	-9.5	-13.8	-7.4	-2.2	-1.9	-0.4	-0.3	-0.4	-2.6	-7.1	-7.2	-0.9
Value of the U.S. Dollar (Trade-Weighted)	108.3	107.0	99.6	98.2	97.0	95.9	95.1	94.3	143.2	112.3	97.7	93.8
Percent Change	-19.1	-4.8	-25.0	-5.3	-4.8	-4.6	-3.4	-3.2	3.5	-21.6	-13.0	-4.0
Flow of Funds (NIA Basis) (Billions of dollars, saar)												
Sources:(total:gross savings)												
Private Saving	650.5	640.8	658.3	652.2	645.0	663.0	691.5	694.3	687.6	678.1	654.6	696.8
Personal Saving	84.1	73.5	107.6	95.7	81.0	89.0	104.5	102.2	143.3	114.1	93.3	104.1
Savings Rate	2.8	2.5	3.5	3.1	2.6	2.8	3.3	3.1	5.1	3.8	3.0	3.2
Gross Business Savings	566.4	567.3	550.7	556.5	564.0	574.0	587.0	592.1	544.3	564.0	561.3	592.7
Federal Deficit	-197.4	-195.9	-177.8	-168.0	-170.0	-177.7	-180.0	-176.3	-198.0	-205.1	-173.4	-182.3
State & Local	64.0	59.4	58.3	60.4	60.9	61.4	62.9	66.1	61.7	63.0	60.2	64.9
Net Foreign Investment	-148.4	-150.6	-149.9	-154.4	-161.3	-164.2	-157.1	-160.5	-115.2	-142.6	-157.4	-160.4
Uses (total:gross investment)	675.8	665.3	699.2	703.7	699.4	707.9	733.5	744.1	661.2	684.2	702.6	740.5
Nonresidential Investment	454.4	455.9	451.8	452.5	455.0	456.6	460.7	464.2	461.4	456.2	454.0	464.3
Structures	129.5	127.1	126.7	127.3	128.0	128.2	129.1	130.0	152.2	134.4	127.5	129.9
Equipment	324.9	328.8	325.1	325.2	327.0	328.4	331.6	334.1	309.3	321.8	326.4	334.4
Residential Investment	197.2	200.2	201.0	199.2	197.4	197.8	198.0	198.6	177.3	194.1	198.9	197.6
Inventory Investment ($ billions)	-0.3	-24.4	9.7	9.5	-0.3	0.1	15.2	15.5	9.0	7.6	4.7	10.1
Selected Interest Rates (%)												
Mortgage Rates												
30-year Fixed Rate Mortgage<1>	9.9	9.4	9.1	8.9	8.8	8.7	8.7	8.8	12.2	9.9	8.9	8.9
1-year ARM (without buydown)	7.3	7.2	6.8	6.7	6.5	6.3	6.3	6.4	10.0	7.9	6.6	6.5
Corporate AAA Bond Rate	8.8	8.7	8.4	8.2	8.1	8.0	7.9	8.0	11.4	9.0	8.2	8.1
Government Bond Rate	7.4	7.5	7.4	7.2	7.0	6.8	6.7	6.9	10.8	7.8	7.1	6.9
Federal Funds Rate	6.2	6.3	6.2	5.9	5.6	5.6	5.7	5.9	8.1	6.8	5.8	5.9
3-month T-Bill Rate	5.5	5.3	5.5	5.1	5.1	5.0	5.0	5.1	7.5	6.0	5.2	5.2
Prime Rate	7.9	7.5	7.5	7.5	7.2	7.2	7.4	7.5	9.9	8.3	7.4	7.5
Discount Rate	5.8	5.5	5.5	5.5	5.2	5.2	5.4	5.5	7.7	6.3	5.4	5.5

<1> FHA Secondary Mortgage Market Rate.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
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